Bill C-90
The Pension Benefits
standards act, 1985

Backgrounder

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Law and Government Division
Research Branch

5 February 1986
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INTRODUCTION

Federal pension benefits standards legislation (the PBSA) establishes minimum standards for all pension plans under federal jurisdiction, except those which cover public service employees. Federally-regulated industries, for example banking, interprovincial transportation, broadcasting, and telecommunications, are governed by this legislation, as are federal Crown corportions. Bill C-90 will be a new Act. It would implement elements of pension reform agreed upon by the federal government and the provinces, which have jurisdiction over a far greater number of employees and pension plan members. It would also revise and clarify provisions in the present Act.

Some sections of Bill C-90 apply only to multi-employer plans. For the sake of brevity these are not discussed in this paper. It should also be noted here that the Act will come into force on 1 January 1987. Its provisions are not retroactive. The implications of this for particular cases will be discussed in detail in the text.

The measures which make up most of the pension reform package are to be found in sections 14 to 28 of the Bill. All of them were described in the May 1985 budget. These provisions would set standards to which plans must conform in order to be registered and eligible for tax benefits.

ELIGIBILITY FOR MEMBERSHIP (s. 14 and 15)

If an employer has a pension plan, all full-time workers who have worked for two consecutive years would be able to join the plan at

the end of that two-year period if they chose to do so. An employer could make membership in the plan compulsory with an exception for employees who object to becoming members because of their religious beliefs.

If there is a pension plan for full-time workers, part-timers would have to be able to join it, or the employer would have to set up a special plan for them. Such a separate plan would be required to provide benefits that are "reasonably comparable on balance" to benefits for full-time workers. The Superintendent of Insurance would have full discretion to determine whether a plan for part-timers met this test. An employer could also make membership compulsory for part-time workers.

A part-time worker is defined as someone who has worked with the employer for two consecutive years and who has earned at least 35% of the YMPE in each of those years. However, a particular plan may be allowed, by regulation, to require a longer qualifying period on the job, or to be more lenient with respect to the amount of money earned during the qualifying period. The YMPE ("Year's Maximum Pensionable Earnings") is the measure on which the maximum C/QPP benefit is based; it is related to the average industrial wage. In 1985, the YMPE was $23,400; 35% of that is $8,190.

Comment

Most studies on pension reform have indicated that pension plan coverage is inadequate: too few workers are members of pension plans. As a result, too many people have an inadequate income after they retire. Some will argue that the proposed provisions do nothing to solve the problem of coverage. First, coverage is not extended by making employers create plans where they did not exist before. Second, where there is a plan, coverage is not mandatory unless the employer chooses to make it so. However, others would argue that pension plans are not the only vehicle for providing retirement benefits. Individuals may choose to save on their own. In tandem with this legislation, RRSP provisions will be broadened to make personal saving easier and to allow employers to contribute to an individual RRSP account. Small business employers argue that this is a good way for them to contribute to their employees' retirement, since it avoids the administrative costs associated with a plan, and is more flexible in terms of the timing of contributions than a formal plan arrangement.

EARLY RETIREMENT (s.-s. 16(2)-(4))

A plan must allow employees to receive a retirement benefit up to 10 years before the normal retirement age set by the plan. (In most plans this is age 65.) The early retirement benefit may be actuarially reduced to account for the fact that it will probably be paid out for a longer period than it would have been had the employee retired at age 65. Reductions may be as high as 6% of the benefit for every year the employee is under age 65.

Comment

This measure has been introduced to provide employees with some choice as to the time they retire. It should be noted, however, that public retirement benefits - old age security and the CPP (not the QPP) - currently begin at age 65. In December 1985 a federal/provincial agreement was reached which would allow CPP benefits to be paid out at age 60, starting in January 1987. The CPP benefit would be actuarially reduced. (It should be noted in this regard that the maximum unreduced benefit in 1985 was about $4,600/year.) No similar proposal has been put forward with respect to the OAS. At any rate it would seem that retirement before age 60 at least might not be practical for a significant number of workers.

VESTING, LOCKING-IN, EMPLOYER'S MINIMUM CONTRIBUTION TO VALUE OF VESTED BENEFIT (s. 17-21)

To say that an employee's contributions or an employee's interest in the plan is vested is to say that he or she is entitled to a benefit of some sort, which in turn may involve the employer's having made some contribution on behalf of the employee. Present legislation does not require that an employee's interest vest until he or she has worked for the employer for at least 10 years and has reached age 45. As a result, workers who do not meet these conditions may be entitled to no pension benefit at all either when they retire (because they have not worked for 10 years) or when they change jobs. In this case all they are entitled to is their

contributions, if the plan is a contributory plan, without interest. In a non-contributory plan, employees who have not worked for 10 years, and employees who are not 45 - no matter how many years they have worked - are entitled to nothing if they leave before retirement. These are minimum provisions and some plans provide for more than the minimum: vesting on the basis of years of service only, a better age and years of service combination, some interest on employee contributions (though often not more than 3 or 4%), and so on.

Under present legislation vested benefits must be "locked-in." This means roughly:

(1) in most cases they cannot be paid out until retirement;

(2) they cannot be treated as any other form of property: they cannot be sold, otherwise transferred (even to a spouse or other relative) or mortgaged. (In legal terms the benefit is "inalienable.")

Also vested benefits are generally not portable: they cannot be carried with the employee when he or she leaves the plan. There is no requirement that the value of a vested deferred benefit be protected from erosion by inflation.

Section 17 of the Bill requires that the employee's interest vest after two years of service. Of course if the employee had worked for only a short period of time before leaving the plan the resulting benefit would be small. Benefits would continue to be locked in, although they could be transferred in the case of marriage breakdown (s. 18). Where benefits payable were minimal, they could be paid out immediately (s.18).

Where a plan is contributory, s. 21 would require an employer to pay at least half of the value of the vested benefit, either at retirement or on an employee's leaving the plan before retirement. As a matter of fact, nearly all contributory plans are designed to ensure that employers have funded half the value of the pension if the employee reaches retirement age. Section 21 is aimed at employees who leave the plan well before that time. Annual funding requirements for these employees are not great, and often the employee's own contributions plus interest earned in the plan fund are enough to generate the deferred benefit. Section 19 would

require interest to be calculated on employee contributions at a rate, fixed by the Superintendent of Insurance, which would reflect market rates current at the time contributions were made. Pursuant to s. 21 the actuarial value of the deferred benefit when the employee leaves the plan must be equal to twice the employee's contributions plus interest; if not, an adjustment must be made in order to provide the employee with a larger deferred benefit. As an alternative to making the adjustment as set out in the proposed Act, the employer may index the deferred benefit yearly according to the formula, 75% of the increase in the Consumer Price Index, minus 1%.

It should be stressed that none of these new provisions would be retroactive. This means that they would apply from 1 January 1987. The provisions of the present Act would apply to years of service up to that time. To illustrate, consider the case of Mary who joins Acme Canada in 1968, when she is 20, and leaves for a more lucrative job in 1990, when she is 42. Acme's pension plan (contributory) follows the PBSA's minimum requirements. Mary's pension entitlement is the following:

(a) for the years from 1968-1985 Mary receives no pension benefit, because her interest did not vest; she would receive her contributions back in 1990, with no interest;

(b) Mary would be entitled to a deferred benefit based on her four years of service from 1987 to 1990. The benefit would not be large.

PORTABILITY (s. 26)

Section 26 would give the employee who leaves before retirement the option of withdrawing his or her "pension benefit credit" (actuarial value of the deferred benefit) from the plan and transferring it to an RRSP "of the prescribed kind." The "prescribed kind" is a locked-in RRSP - one which cannot be collapsed until retirement. Investment earnings on the RRSP would help preserve the value of the benefit. The employee would continue to be able to transfer the benefit to another plan, if this were allowed by the other plan, or to leave it in the original plan. The employee would be required to notify the plan administrator of his or her choice within three months of leaving the plan.

The employee's choice with respect to portability would be limited in two ways. If the actuarial value of the deferred benefit was less than 10% of the then current YMPE, the pension plan could specify which option was available to the employee. Also if the transfer of money out of the plan would hurt the solvency of the plan, the Superintendent could refuse to allow the transfer. The Superintendent would then be given the discretion to determine the conditions under which a transfer could take place.

Comment

As the text shows, workers who change jobs - not necessarily frequently - are hurt by present pension legislation. The proposed legislation would benefit them. It should not be forgotten, however, that workers in mid-career when the legislation comes into effect will not profit from it to the extent that their successors will, because the provisions are not retroactive.

SURVIVOR BENEFITS (s. 22-24)

Present legislation does not require plans to have survivor benefits; benefits may be paid for the life of the plan member only. Bill C-90 would provide for survivors of members who die after retirement ("post-retirement" survivor benefit, s. 22) and before retirement ("pre-retirement" benefit, s. 23).

The term "survivor" refers to a married surviving spouse or a common law spouse, if the common law spouse has been living with the retiree (plan member) for at least one year at the time of death. If both a married spouse and a common law spouse (as defined) exist, the benefit goes to the common law spouse (s. 2).

After 1 January 1987 a plan must offer a retirement benefit with a survivor feature. As a minimum the survivor benefit must be 60% of the initial pension to the retiree, but the plan may also provide that the benefit must reduce to 60% if the spouse should die before the retiree.

The employer is not required to assume any significant extra cost on account of this provision: if the plan has no survivor benefit, the actuarial present value of the benefit with the survivor feature is allowed to equal the actuarial present value of the benefit without it; this is also the case with respect to plans with, say, a 50% benefit, which do not reduce at first death. This means that in many cases the initial benefit to the retiree will be less than it would have been had the survivor benefit been less than 60% (or had not existed at all). For this reason Bill C-90 would require plans to offer members the choice of receiving a benefit which is not adjusted for a survivor in the manner required, or which is. If the choice would result in the surviving spouse receiving less than 60% of the initial benefit to the retiree under the alternative scheme, the choice could not be made without the written consent of that spouse.

If an employee died before retirement the death would be treated as a plan termination, and the spouse would be entitled to the part of the employee's benefit which is attributable to years of service after 1 January 1987. The spouse may deal with the benefit in the same way as a terminating employee (transfer to a locked-in RRSP, etc.) and would be subject to the same restrictions. In the alternative, the plan may provide that an equivalent or greater benefit be paid out to the spouse immediately.

Survivor benefits would not be allowed to terminate because the survivor had remarried.

None of these provisions is applicable to those who are survivors now. If they are not entitled to a benefit under existing plan rules, Bill C-90 will not change their situation.

DISTRIBUTION OF PENSIONS ON MARRIAGE BREAKDOWN (s. 25)

According to the May 1985 budget, pension legislation was supposed to have provided that on separation or divorce the portions of the vested benefit or pension being paid which were attributable to the marriage would be split equally between the spouses. This has not been done. Instead, Bill C-90 would cede jurisdiction in this area to provincial matrimonial property law, with one exception - a plan member or retiree may choose to split the pension, whatever provincial law provides.

As an aside, it should be noted that Bill C-90 would include common law couples in these provisions. The definition of a common law couple is similar to that used for the survivor benefit; that is, two persons of the opposite sex who were cohabiting but not married. However, in fact there are very few provinces whose matrimonial property law applies to common law situations.

Comment

At present, it is not clear that every province has legislation which gives a spouse an interest in the other's pension on marriage breakdown. Even where pensions may be shared, no legislation but Manitoba's requires that pensions be divided in such a way as to retain their character as pensions - benefits which are not available until retirement. In the other western provinces and in the new Ontario family law legislation, for example, pensions may be traded or set off against other property, leaving one spouse with a pension and the other with a lump sum. Many women's groups are critical of this outcome. They argue that since plan members are not allowed to cash in their share of a vested benefit, spouses should not be allowed to do so either.

One can only speculate as to the reason the federal government did not go through with the initial plan for splitting pensions on marriage breakdown. It might be argued that it is not within federal jurisdiction to do so, since the issue is not essentially a pension issue, or ancillary to a pension issue, but rather a matter of property and civil rights in a province. However, equally forceful arguments may be made that these specific provisions for alienation of pension benefits are indeed ancillary to pension legislation.

DISCLOSURE (s. 28)

Within six months of the plan's year end each member and his or her spouse would have to be given the following information relevant to the member's pension:

- total contributions made by the member
- the pension benefits to which the member is entitled under the plan at the end of that year
- the funded ratio of the plan (the ratio of assets to liabilities. This measure may be relevant in determining what amount the employee can transfer from the plan on termination.)

Members and their spouses would have limited access to actuarial and financial statements of the plan. They would also have to be provided with a written explanation of any plan amendment. Disclosure of additional information may be prescribed by regulation. Further provisions relating to disclosure will be dealt with in the section on administration.

Comment

A record of total contributions may not be as valuable as a list of contributions made each year - so that the employee could ensure that the proper amounts were credited to him or her. The interest rate attributed to these contributions should be shown. For purposes of dividing pensions on marriage breakdown, it would be useful to be given the member's "pension benefit credit" - the actuarial present value of the benefit. It is unclear whether the Regulations will require this information.

SEX DISCRIMINATION PROHIBITED (s. 27)

Section 27 would prevent employers from requiring, for example, that female employees contribute more to the plan or receive smaller benefits than male employees with the same earnings history on the grounds that women as a group live longer than men as a group, and so are likely to require longer benefit payouts. This is not a problem in defined benefit plans, where cross-subsidization of many kinds ordinarily occurs. It is a problem in money purchase plans, where the benefit is provided by an annuity. Employers would not be forced to use unisex mortality tables in

providing the annuity although they could do so. They could also contribute more on behalf of females, or do anything else which would ensure that all workers with similar earnings receive similar benefits.

REMOVAL OF SURPLUS (Subsection 9(5))

This is an important addition to the Bill made at the Committee stage. When the Bill was introduced it made no provision with respect to the withdrawal of a plan surplus by the employer. Subsection 9(5) now provides that no surplus may be removed unless this is permitted by the Regulations, and the Superintendant of Insurance, who administers the Act, consents. It should be noted that a surplus is defined as the excess of a plan's assets over its liabilities, where the plan liability is equal to the sum of the liability for pensions already being paid out to pensioners, and the liability for pensions which will be paid out when present employees retire.

The Regulations to the Act have not been published at the time of writing. However, federal officials indicate that with respect to this issue the thrust of the regulations will be to ensure the following:

- that plan documents provide for a withdrawal of surplus by the employer
- that plan members and retired members are notified of the employer's intention to withdraw the surplus
- that the plan continues solvent

ADMINISTRATION (s. 7 and 8)

A number of the provisions in these sections have not been highlighted as reforms. However, they change present federal law in important ways, and should be noted.

The Bill proposes that the administrator of the plan be the employer (with exceptions for multi-employer plans). As administrator the employer would be responsible for managing plan benefits and the plan fund,

and for ensuring that the requirements of the Act are met. The administrator would also have a duty to preserve benefits already being paid and benefits accruing to active plan members. If there was a conflict of interest between the employer's role as administrator of the plan and the employer as a business entity, it would have to be resolved in the best interests of plan members. The employer would be required to disclose such a conflict to members. An employer who did not do so could be taken to court by any "interested party." The court would be given the power to order whatever remedy it thought fit.

The Bill would also set a standard of behaviour for an administrator: to act as a "person of ordinary prudence would ... in dealing with the property of another person." The "prudence" test would be strengthened by requiring all those who ought to have a particular level of knowledge or skill in the administration of the plan or the fund to exercise that knowledge. Where the employer is a corporation, which in law acts through its directors and chief executive officers, the stronger test will always be applicable. It should be noted that the prudence test is one which in Canada is applied to trustees, and has received elaboration through judicial decision making.

As proposed in the May budget, the Bill would create a new administrative body - the pension committee. A committee must be established if the plan has 50 or more active members and a majority of these requests one. In this case the committee must include a representative of the members chosen by them. If a committee is established, and if a plan has 50 or more retired members (pensioners), the committee must include a pensioner representative, if the majority of pensioners request this. Regulations will prescribe the way in which representatives are to be chosen. The purpose of the committee is to promote awareness and understanding of the plan among active employees, and to review annually benefit payments, the financial status of the fund, and funding arrangements. Other duties may be prescribed by Regulations. The employer must provide the committee with whatever information is required to carry out its duties.

The administration sections also contain new and detailed provisions regarding money and assets in the fund or owing to the fund. The employer is deemed to be a trustee of the following amounts: money in the fund; employer contributions for accrued current service and special payments on the unfunded liability; employee contributions; and any other amounts owing. The deemed beneficiaries of the trust are plan members and anyone entitled to receive a benefit (e.g. pensioners and survivors). Money owing to the fund but not in the fund must be kept separate from the employer's own assets. If the employer became bankrupt, or its assets were liquidated for other reasons, the fund would have priority over other creditors for amounts deemed to be in trust, whether or not they had been separated from the employer's assets.

Comment

To the writer, the provisions regarding administration are a departure from those of the current legislation. The thrust of the present PBSA and the Regulations is arguably to make plan administration independent of the employer to some extent. This is done by requiring the fund to be run by individual trustees, by a trust company, a life insurance company or similar groups as set out in the Regulations. It is true that the independence of the trustee may be severely restricted, in that the employer is able to set fund investment policy and determine the amount of pension benefits through the provisions of the pension plan, which trustees must adhere to. Nonetheless, the risk of conflict between the employer's interest and those of the plan beneficiaries is diminished, as is the perception that the plans are run for the benefit of employers, perhaps sometimes for active members but never for pensioners. One might reply that the proposed Bill would deal with cases of conflict. It is not clear, however, whether its provisions are adequate. Funding and accounting for pension plans are very complex processes. An employer may not be in the best position to determine whether or not a conflict exists. In general, plan members will be even less able to detect a conflict. Even if they are, litigation is an expensive way to assert one's rights.

CONCLUDING REMARKS

What will happen to us when we retire is an important subject, especially as we near retirement age. But pension plans are complex arrangements; inevitably Bill C-90 is an intricate piece of legislation, which cannot be easily mastered or briefly described. The provisions dealt with in this paper are at the heart of the Bill; however, it should be noted that many of its aspects have not been discussed.